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# Investors and the Paris Agreement: a comment on the draft regulation on "disclosures" in the light of the financial consistency principle

Good morning ladies and gentlemen,

In January this year, the Federal Council for Sustainable development of Belgium has organized a seminar with asset managers and institutional investors where we discussed how they could best contribute to financing the transition towards a carbon-neutral and sustainable economy. This seminar was organized with the collaboration of the EEAC network.

In order to best reflect the major issues of public interest behind this financial discussion, we also invited NGOs promoting sustainable finance and the Belgian authorities responsible for ensuring financial stability by supervising these asset managers and institutional investors.

Although my council hasn't been able to draw official recommendations regarding the issue yet, I'm very pleased to discuss it here today with you in my personal capacity, and very grateful to the Quality Net Foundation and to Yvonne Zwick for the invitation.

Since the Rio Conventions of 1992, the fight against climate change and the loss of biodiversity have been occupying an increasingly important place in the political agendas of our governments, but also in the economic and financial world. But the paradox is that the climate and biodiversity targets are not on track at all. In 2018, the average emissions of the EU countries have increased of 1.8 %, and they continue to increase at the global level. Today, Greta Thunberg tells us that the policies put in place so far will not solve the climate crisis, and she also points out that our governments don't really have the political will needed for that.

I think that a major indicator of political will is to look at what the governments effectively do for "*making financial flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development*", in accordance with their commitment under the Paris Agreement – a commitment for, what I would call, financial consistency.

The new European regulation on the Governance of the Energy Union and Climate Action already provides clear accounting rules for domestic climate finance. So, in principle, we could expect more transparency regarding whether (or not) our governments sufficiently secure the amounts of public and private finance that are needed for complying with their objectives and contributions. The regulation clearly reflects the financial consistency principle of the Paris Agreement – as far as the objectives for 2030 are concerned.

The Commission's Action Plan on Sustainable Finance has added essential elements for re-orienting financial flows towards achieving the transition towards a carbon-neutral and sustainable economy. The 3 regulations proposed on May 24 last year (taxonomy, benchmarks and disclosure) could significantly impact on investors in terms of contributing to financing this transition. However, the condition for this, I contend, is that we reconsider the way in which the legal responsibilities of these investors are defined: what is a "prudent person" ? what does "due diligence" mean ? what are "fiduciary duties" ?

In order for investors to be "prudent" or "diligent", they need one thing: information, the information that they can use for comparing different financial products. This is what the draft regulation on disclosures deals with.

Regarding climate change in particular, the need for disclosure is also related to the financial risks and opportunities that have been highlighted by the Task Force on Climate-related Disclosures of the Financial Stability Board in its report of June 2017. Since then, central banks and supervisors pay more and more attention to the impacts of climate change on financial stability.

It is clear that the financial risks and opportunities of climate change provide a compelling argument for investors to take climate change into account. Now the question is : how can they do it concretely ? They can divest from brown economic activities by excluding "stranded assets", or they can invest in green projects, with a view to achieving a contribution to the global goals on climate. The speakers at our seminar agreed on the fact that the investors which declare that they integrate sustainability are likely to follow the first approach – divest - rather than the second one – invest:

Now I would like to illustrate this more concretely for the case of pension funds. *"Pension funds' long term liabilities make them ideal providers of sustainable finance (…) as the beneficiaries expect income streams over several decades".* But still, if I take my country as an example, more than 50% of the Belgian pension funds don't consider sustainability at all as a factor for investing or do consider it, but only when it has no negative impact on return.

Pension funds need return on investment to provide their members' retirement income, but the requirement for return also clearly stands in the way of sustainable investments by pension funds. I say this because today, pension funds can still call on the prudent person rule for not incorporating sustainability considerations in their investments.

Is that good ? Is that "optimal" ? Do the pension funds long-term investment policies not also make their assets potentially more exposed to long-term risks ? What about the losses stemming from policy changes in the carbon-intensive sectors the fund invests into ? What about missed opportunities when a sector "lags behind" because of changes of consumers preferences? What about reputational issues when green products turn out to be less green than expected ?

Can we still say then that the investor acts as a prudent person? Should we not say instead that he is no longer a prudent person when he doesn't take such risks and opportunities into account ? The European Parliament proposed to amend the disclosure proposal in that spirit,

by introducing an obligation for investors to have in place due diligence policies with regard to sustainability.

The amendments of the EP defined due diligence as “the continuous process of reasonable care and investigation through which an investor (…) identifies, avoids or mitigates, accounts for and communicates about (…) sustainability risks, prior to making an investment and until sale or maturity of the investment”.

The amendments also included a couple of concepts which are potentially useful for investors to comply with due diligence:

First, a clear definition of “sustainability risks” including not only short-term, but also long-term risks for the return of the financial product but also for the natural environment, including but not limited to when linked to the financial return.

Secondly, the need to look for sustainability performance (or impact) on the basis of a set of harmonized indicators.

Thirdly, target setting, which is very important, for example for performance accounting.

Fourthly, integrated reporting from investee companies, namely reporting that incorporate both financial and non-financial data.

Fifthly, the exercise of shareholder voting rights and engagement with companies.

Before I finish I would like to ask a further question regarding due diligence: does it not also consist into how investors, like other economic actors, contribute to the collective interest of climate policy, in accordance with the financial consistency principle of the Paris Agreement ?

Thank you for your attention !